

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

ORIGINAL
WITH PROOF
OF SERVICE

77-7098

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

B

RICHARD I. CLARK, as Executor of the
Estate of BERNICE C. GRUPE,

Plaintiff-Appellee,

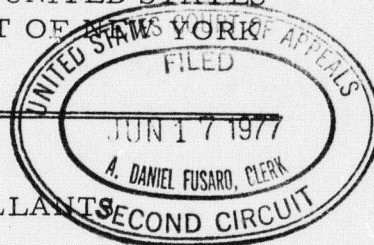
p/s

-against-

JOHN LAMULA INVESTORS, INC. and
JOHN J. LAMULA,

Defendants-Appellants.

ON APPEAL FROM A FINAL JUDGMENT OF THE UNITED STATES
DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK



REPLY BRIEF OF DEFENDANTS-APPELLANTS

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(6394)

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UNITED STATES COURT OF APPEALS
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RICHARD I. CLARK, as Executor of the
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-against-

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LAMULA,

Defendants-Appellants.

75 Civ. 2083
Docket No. 77-7098

REPLY BRIEF OF
DEFENDANTS-
APPELLANTS

Some of the material contained in Plaintiff-Appellee's brief
requires a reply.

This reply brief will be divided into five basic areas:

1. Misstatements of Fact.
2. Plaintiff's erroneous conclusions on the jury findings.
3. The pervasive prejudice to defendants-appellants of the
totality of this trial.
4. No statutory fraud found; the suitability finding was
erroneous as a matter of law and against the weight of the evidence.
5. The damages should be reduced to the amount that defendants
profited, not what plaintiff lost.

PLAINTIFF'S MISSTATEMENTS OF FACT

P. 1 The reference to the anti-fraud provisions of the Federal Securities Law contained in paragraphs 2 and 3 is erroneous. Defendants contend that no statutory fraud was found here. Defendants' conclusion is supported by the jury findings, particularly 1-3A. This case is a suitability case which should not, as a matter of law, be the subject of a private action for damages. At most the complaint should have and could have been handled administratively under the NASD rules.

P. 2
para.
2(iii) The statement that defendants concealed from plaintiff other information relevant to her investment decision is not supported by the jury finding. The jury specifically found in its answer to 1-6b and particularly 1-6c that Mr. Lamula informed her of market conditions, market activities, market prices and other material matters respecting the debentures, the companies issuing them, their market quality. There can be no intent to deceive on the part of defendants given the fact that Mrs. Grupe specified that she did not want to invest in stocks or real estate and did specify her investment needs, which Mr. Lamula met.

P. 2-5 The statement in paragraph 5 misstates the basis for defendants' objection to the "junk bond" reference and is totally inaccurate on the question of whether an objection was made by defendants' trial counsel. No sooner was the term "junk bonds" uttered when defendants objected to its usage (A-128-129). The Court permitted the reference and the stage was then set for the 80 other times that this term was used at the trial. The error complained of goes far beyond the narrow construction of the error question that plaintiff would like to see. Both the Court and plaintiff's counsel made repeated references to "junk bonds" throughout, as will be seen herein, and this highly inflammatory and prejudicial term deprived defendants of a fair and impartial trial on the issues.

P. 5 The reference to rescission allegedly demanded by Mrs. Grupe is nowhere in the testimony because it never happened; and, therefore, there was no finding by the jury on the question. Mrs. Grupe never discussed rescission with Mr. Lamula. Mr. Lamula, however, offered to systematically dispose of these securities over a period of time to avoid the detrimental impact from the dumping of these securities that occurred in this case. His offer was declined.

P. 11 The allegation that JLI purchased and sold the securities on the same day for a so-called "riskless transaction" was contradicted by the evidence on the back of the order slips which showed a sale date of May 23, 1974. This evidence meant it was not a riskless transaction.

P. 16 The repeated references to the refusal of defendants to rescind or dispose of the debentures is not supported by the evidence. Again, it is a subtle attempt, as was done throughout this case, to plant a concept without supporting testimony.

PLAINTIFF'S ERRONEOUS CONCLUSION ON JURY FINDINGS

P. 19
I-6(a) Mr. Lamula did not conceal from Mrs. Grupe how the debentures were rated. He told her that because of the special situation inherent in these debentures he did not put any faith in the rating services for these securities. Keep in mind that Lamula only recommended these debentures after Mrs. Grupe defined her investment criteria of \$12,000 income per year. Lamula's entire business revolved around these special situation convertible debentures which had proven successful for his investors and which he meticulously explained to plaintiff over ten meetings. Furthermore, many better-known securities were similarly rated or not rated at all so ratings with respect to these special situation securities were meaningless.

I-6(d) The constant reference to the word "concealed" is misleading and inaccurate. JLI did not inform her of other suitable investments for the reason, as explained in the record, that Lamula knew nothing about other investment opportunities of a suitable nature and he made no representations that he did. He was an expert in the limited area of convertible debentures. Must every broker now

inform every customer of every possible way to invest money, despite the investor specifying her income needs beforehand? Not informing Mrs. Grupe for the reasons stated in the context of the testimony in this case is far different from "concealing".

P. 19
1-6(e) The reference to concealing the fact that Mrs. Grupe could not expect a \$12,000 yearly income unless she bought speculative securities involving great financial risk is another distortion. The jury found that in the course of recommending debentures to plaintiff Lamula did not inform her that she could not expect to acquire \$12,000 yearly from her investments unless she bought speculative securities involving great financial risk. In effect the jury said he never said it. It's a finding for defendants, rather than for plaintiff. Counsel for plaintiff is correct, however, that the word "reasonably" in Interrogatory 16 should read "unreasonably."

P. 19
1-13 The finding in Interrogatory 13c is inexplicable when compared with the finding in 4A and 5A. How could Mr. Lamula and his company buy securities with an intent to deceive plaintiff if the jury also found that, in effect, he did inform her in the course of recommending the debentures to her that he would buy for inventory most of the debentures actually sold only (5A) and that he was the market maker (4A)?

A major cause of the inconsistency and the confusion inherent in the jury's findings is the phraseology of the interrogatories which contained so many double negatives or confusing statements of the questions presented to this jury. This results in considerable disagreement on what was actually found. This Court should rectify this confusion by granting a new trial.

POINT I

THE TERMS "JUNK BOND", "PIGEON",
"HIGH ROLLER" AND "JIMMY THE
GREEK" PREJUDICED DEFENDANTS
AND MANDATE A NEW TRIAL IN THE
INTERESTS OF JUSTICE.

The repeated references to "junk bonds" by the Court and by plaintiff's counsel, the prejudicial and inflammatory summation of plaintiff's counsel and the repeated prejudicial retorts of the Court mandate a reversal in the interests of justice.

JUNK BONDS

There are 81 specific references to "junk bonds" in this record, not the few references conceded by plaintiff. When first mentioned, the term was objected to (A 128-129). In a case of this type involving the suitability of convertible debentures, the repeated references by the Court and plaintiff's counsel implant a characterization of these securities in a financially unsophisticated juror's mind that is hopelessly prejudicial to defendants. No attempt to minimize such prejudice can obscure this fact when suitability of convertible debentures is at issue.

PLAINTIFF'S SUMMATION

Plaintiff's counsel made repeated reference throughout his summation to the plaintiff being defendant's "pigeon" (A 1219, 1220, 1223). Likewise the term "high roller" was used (A 1207). Such terms are common in gambling discussions. Again, in light of the issue in this case, these characterizations fatally tainted this case.

JUDGE'S REMARKS

Plaintiff would like to gloss over the repeated prejudicial remarks of the trial judge. In a case like this, reference to "Jimmy the Greek" (A 609), a notorious gambler; the ridiculing of defendant by reference to the "This is Your Life" television program when defendant was testifying; and other equally unnecessary remarks are disastrous to defendants because they introduce the "gambling" concept to this case and demean defendants.

All of the above must be viewed together as part of the totally prejudicial atmosphere and conduct of this trial, and in the interest of justice a new trial should be ordered.

Just this past week, on June 6, 1977, the District Court, Pollack, J., in Drasner v. Thomson McKennon Securities Inc. granted defendant's post-trial motion to dismiss the complaint on the grounds, inter alia, that:

"the trial was prejudicially marred by unwarranted inflammatory conduct on part of plaintiff, which was persistent throughout and was calculated to and did divert the minds of the jury from the issues in the claims on trial, and thereby resulted in a trial of a party to the litigation, rather than a trial of the claims in suit." Drasner v. Thomson McKennon Securities Corp., S.D.N.Y. June 6, 1977, p. 6.

In Drasner, as here, the summation was inflammatory and prejudicial. Reference to gambling was present in Drasner, as here. "Pigeon" replaces allusions to a "bucket shop." "Fixed gambling" was replaced by the court's reference to "Jimmy the Greek", a notorious gambler, now a well-known television personage, as a result of his odds making acumen in Las Vegas. This kind of prejudicial reference and atmosphere introduced

thoughts not properly before the jury in this type of case.

Judge Pollack found that trial conduct similar in purpose and effect has been held grounds for ordering a new trial, citing Koufakis v. Carvel, 425 F. 2d 892, 904 (2nd Cir. 1970) (allusion to Mafia characterization of Carvel); N. Y. Central R. R. Co. v. Johnson, 279 U.S. 310 (1929); Secor v. Heynes, 205 N.Y.S. 348 (1st Dept. 1924); Laughing v. Utica Steam Express & Water Works, 228 N.Y.S. 2d 44 (4th Dept. 1962); Drasner v. Thomson McKennon Securities, Inc., supra, at page 8, 9.

POINT II

RULE 51 AND RULE 49(a) DO NOT PRECLUDE
APPELLATE CONSIDERATION OF PREJUDICE
RESULTING IN A MISCARRIAGE OF JUSTICE.

Plaintiff's attempt to invoke the provisions of Rule 51 and Rule 49(a) is misplaced. In the case at bar the prejudice as a result of the inflammatory summation of the plaintiff's counsel and the gratuitous remarks of the court resulted in fundamental errors creating a grave miscarriage of justice. This Court may, and should, take notice of this fact because it was a major factor in a gross miscarriage of justice. Hoffman v. Sterling Drug Co., 485 F. 2d 132; Pritchard v. Liggett and Myers Tobacco Co., 350 F. 2d 479, cert. den. 382 U.S. 987; Paluch v. Erie Lackawanna Railroad Co., 387 F. 2d 996; McNello v. John C. Kelly, Inc., 283 F. 2d 96.

See also Drasner, supra, at p. 10 on the binding effort of stipulations and agreements of the parties, citing Estate of Sanford v. Commissioner, 308 U.S. 39, 51 (1939).

POINT III

NO STATUTORY FRAUD WAS FOUND HERE,
OR, IN THE ALTERNATIVE, ANY FRAUD
OR UNSUITABILITY FINDING IS CON-
TRARY TO LAW, AGAINST THE WEIGHT
OF THE EVIDENCE, AND THE PRODUCT
OF THE PREJUDICIAL ATMOSPHERE OF
THE TRIAL.

In his charge to the jury, the Court stated at A-1251:

"To find against the defendant on the allegations dealing with statutory fraud you must find that they misled the plaintiff and misrepresented important facts to her." (emphasis supplied)

The jury specifically found in Interrogatory 3 that Mr. Lamula did not make any untrue statements of fact about the debentures to Mrs. Grupe, and on which statements Mrs. Grupe reasonably relied. Such a finding negates the statutory fraud argument relied on by plaintiff.

Assuming, arguendo, that under one possible interpretation of the evidence and there was a question of fraud, the contrary evidence and findings should compel this Court to tread cautiously and let the regulatory body determine what is suitable since they, rather than a jury, are best able to judge without the prejudice and contradictory findings present in the case at bar. See note in Plunkett v. Dominick & Dominick, Inc., CCH Fed. Sec. L. Reg., para. 95,728 D.D. Conn. April 27, 1976, Newman, J., and the cases cited therein, particularly SEC v. Geon Industries, Inc., Nos. 74-2614, 74-2657 and 75-7010 (2d Cir. Feb. 9, 1976).

Furthermore, since "suitability" under NASD rules is not specifically defined, it is respectfully submitted that the implication of a private cause of action under the rule should be narrowly drawn and rarely, if ever, permitted. Hecht v. Harris Upham & Co., 283 F. Supp. 417, 430. See Civil Liability for Violation of NASD Rules: SEC v. First Securities Corp., 121 U. Pa. L. Rev. 388, 394, 96 (1972). This principle of narrowly constructing an actionable claim was discussed by Judge Pierce, in Rolf v. Blyth Eastman Dillon & Co., Inc., CCH Fed. Sec. L. Reg. Para. 95843 (SDNY January 18, 1977, Pierce, J.); and has been found by other courts. See Buttrey v. Merrill Lynch, 410 F. 2d at 143 (7th Cir.), cert. denied 396 U.S. 838 (1969); Geyer v. Paine Webber Jackson & Curtis Inc., 389 F. Supp. 679 (D. Wyo. 1975) (mere negligence insufficient); Wells v. Blythe & Co., 351 F. Supp. 999, 1001 (N.D. Cal. 1973) (rules violations not "per se" actionable); McCurnin v. Kohlmeyer & Co., 347 F. Supp. 573 (E. D. La. 1972) (plaintiff must prove at least a knowing and callous disregard for the rules).

In order to be actionable in this Court the NASD rules violations must be tantamount to fraud and must have operated as a fraud upon plaintiff. Defendants must have acted with scienter, that is, with intent to defraud or with willful and reckless disregard for the truth of falsity of their representations or of whether their actions constituted fraud. Rolf, supra; Lanza v. Drexel & Co., 479 F. 2d 1277, 1306 (2nd Cir. 1973) en banc; Arthur Lipper Corp. v. SEC, NO 76-4067 (2nd Cir. Dec. 10, 1976), SLIP Opinion 901 at 918.

No such finding was made here nor could it have been made on the evidence presented to the jury.

The jury found

1. No untrue statements of fact were made by Lamula. I-3.
2. Lamula was a market maker in these securities. I-4A.
3. Lamula informed Mrs. Grupe that he would buy for inventory. I-5A.
4. Lamula told her of market conditions, market activity or market prices with respect to these debentures. 1-6b.
5. Lamula told her of other material matters respecting these debentures, the companies issuing them and their market quality. 1-6c.
6. He did not tell her that if she didn't buy speculative securities she could meet her investment criteria. 1-6e.
7. Mrs. Grupe was not entirely dependent upon Mr. Lamula for investment guidance; 1-2-a, i.e., she relied on herself (because she was sophisticated) or someone else (emphasis supplied).

When considered together with the other facts contained in the defendants' main brief, the above findings negate scienter and negate the necessary misrepresentations, material omission and reliance which must be present if there is a fraud to be found.

In plaintiff's brief, only passing reference is made to the fundamental fact that it was Mrs. Grupe who established the investment criteria from which all else followed. Mrs. Grupe was a sophisticated, educated, intelligent, world-wise teacher, consultant (for I.B.M.), legislative aide, whose second divorce had left her with over \$100,000 to invest for income and capital appreciation. The jury specifically found that she was not entirely dependent upon Mr. Lamula for guidance in selecting her investments (I-12a). She didn't want to invest in stock or real estate and she said so. She was selective and independent enough to cancel one of the proposed purchases (Seaboard) which, because of her decision, was purchased on June 21 and eventually cancelled on July 2. She knew exactly what she was doing when she refused Mr. Lamula's suggestion that she consult her son, who was a lawyer, or her broker. She only invested in these debentures after the most painstaking explanation of all material aspects of these investments was received by her from Mr. Lamula in the course of ten meetings.

Having done so and having begun to realize her investment objective, she then was persuaded by her nephew, who was in investments, to drop these suitable securities at a loss to herself.

Under the facts of this case the jury's findings that the securities were unsuitable is contrary to law and against the weight of the evidence, since these securities met Mrs. Grupe's investment need.

If this verdict is left standing then any broker is at the mercy of any customer who established the investment criteria and then thwarts the objective by dumping the securities in a bear market for the purpose of commencing litigation.

This is an unconscionable result, which can only be explained by the misleading and inconsistent interrogatories and the prejudicial atmosphere that pervaded this trial.

POINT IV

THE DAMAGE AWARD WAS EXCESSIVE.

The applicable law on the question of damages under the facts of this case, in particular the fact that plaintiff herself dumped these debentures (which were to be held long term) within three months of purchase, in one of the worst bear markets in history, should be as stated by Judge Pierce in Rolf, supra.

In Rolf, the Court took cognizance of the fact that much of the damage suffered by plaintiff was the result of a bear stock market and that it would be highly inappropriate to allow plaintiff to recover his losses by assessing them against defendants. Rolf, supra, at 95843. In the case at bar, there was a bear market of the first order (the Nixon market) plus the fact she dumped these securities within a short time after purchase. Therefore, as in Rolf the measure should be the amount of benefit received by defendants in this case, not the losses incurred by plaintiff's own actions.

The record shows that she gave Lamula no opportunity to mitigate her alleged loss and in fact intentionally created the situation through a carefully contrived plan. Even if she had bought other types of securities, had she dumped these securities at the time and in the manner that she dumped the debentures, she still would have suffered losses. Mr. Lamula should not be held responsible for Mrs. Grupe's actions.

CONCLUSION

THE TOTALITY OF THE ERRORS THAT
PERVADED THIS TRIAL MANDATES
THE DISMISSAL OF THE COMPLAINT
OR A NEW TRIAL.

Respectfully submitted,

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William F. Plunkett, Jr.
Of Counsel

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss .

ROBERT LA GRASSA, being duly sworn,
deposes and says that deponent is not a party to the action,
is over 18 years of age and resides at 62-20 60th R .
MASPETH, NYC

That on the 17th day of JUNE, 1977,
deponent personally served the within REPLY BRIEF OF DEFENDANTS-
APPELLANTS

upon the attorneys designated below who represent the
indicated parties in this action and at the addresses below
stated which are those that have been designated by said
attorneys for that purpose

By leaving 2 true copies of same with a duly
authorized person at their designated office.

~~By depositing true copies of same enclosed~~
~~in a postpaid properly addressed wrapper, in the post office~~
~~or official depository under the exclusive care and custody~~
~~of the United States post office department within the State~~
~~of New York.~~

Names of attorneys served, together with the names
of the clients represented and the attorneys' designated
addresses

SILBERFELD, DANZIGER & BANGSER
Attorneys for Plaintiff-Appellee
230 Park Avenue
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Robert La Grassa

Sworn to before me this

17th day of JUNE, 1977.

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Queens County
Commission Expires March 30, 1979

